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TO RUEHC/SECSTATE WASHDC PRIORITY 0563
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RUEHFSI/DIR FSINFATC PRIORITY
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RUEHKSO/AMCONSUL SAPPORO PRIORITY 0151
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RUEHFK/AMCONSUL FUKUOKA PRIORITY 0139
RUEHNH/AMCONSUL NAHA PRIORITY 0161
RUCPDOG/USDOC WASHDC
RUEHBJ/AMEMBASSY BEIJING 0395
RUEHUL/AMEMBASSY SEOUL 1085
RUEHBS/USEU BRUSSELS 0015
RUEHFR/AMEMBASSY PARIS 0020

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SIPDIS

DEPT FOR E, EB, EAP/J
STATE PASS USTR FOR AUSTR CUTLER AND MBEEMAN
STATE PASS FEDERAL TRADE COMMISSION FOR GENERAL
COUNSEL BLUMENTHAL
FTC ALSO FOR INTL ANTITRUST - TRITELL/SHANAHAN
JUSTICE FOR STU CHEMTOB IN ANTI-TRUST DIVISION
STATE PASS TO NSC FOR TONG
USDOC FOR ITA/OFFICE OF JAPAN MELCHER
NFATC FOR LISA FOX AND BARRY BLENNER
PARIS FOR USOECD

SENSITIVE

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SUBJECT: BID RIGGING IN JAPAN: A FEATURE, NOT A BUG

11. (SBU) Bid rigging (dango in Japanese) is a common form of corruption in Japan, in which firms restrict open competition by coordinating their bids on procurement or public contracts. Although not unique to the Kansai area surrounding Osaka in western Japan, recently one example of bid rigging came to light in Osaka's southern neighbor of Wakayama that shines light on the practice as a whole.

BACKGROUND

12. (SBU) On October 13, the Osaka District Public Prosecutor's Office arrested Wakayama Prefecture Treasurer Satoaki Mizutani and 4 others in conjunction with its expanding probe of alleged bid rigging in four public works projects ordered by the Wakayama Prefectural Government in 2004. The investigation also targets current and former executives of the Obayashi Corporation, a major Osaka-based construction company. An Osakan golf course owner close to Governor Yoshiki Kimura is suspected of taking 60 million yen (over USD 500,000) from the successful bidders for advance details of the projects. Although Obayashi did not participate in the bidding, Osaka authorities suspect that the conglomerate was exerting control over the amount offered by bidders.

BID RIGGING: A CASE STUDY

13. (SBU) More interesting than the particulars of the

unfolding criminal case is the glimpse the case offers into the rationale for the deeply ingrained system of rigging bids in Japan -- a practice that shows no signs of abating any time soon.

OBAYASHI: GODFATHER OF BID RIGGING IN THE KANSAI

14. (SBU) Osaka media interlocutors tell us that former Obayashi Managing Director Sakae Hirajima personally selected bid winners and controlled bid prices for thirty years starting in the 1960s. Known as the Godfather of construction companies in the Kansai, prospective bidders reportedly had to supplicate themselves to him in order to clinch deals on all public projects. Hirajima left Obayashi after a large corruption scandal and disclosed details of his firm's bid rigging practices to the Japan Fair Trade Commission (JFTC) in 1997.

15. (SBU) Predictably, although the JFTC subsequently clamped down, a less direct system for rigging bids soon filled the vacuum left by Hirajima's departure. In the current system, a number of major construction companies, many of which are based in Osaka, take turns at dictating bid conditions. In Obayashi, reportedly there is now a team of executives in charge of bid rigging divided to two groups: one for road and tunnel projects, the other specializing in buildings.

FROM BID RIGGING TO "BID DUMPING" IN PUBLIC WORKS

OSAKA KOBE 00000588 002 OF 003

16. (SBU) While detected bid rigging cases have declined since 1997, so has the Japanese economy as a whole. But Toshikazu Ito (please protect), a Technical Coordinator of the Kinki Regional Development Bureau, Ministry of Land and Infrastructure (MLIT) reported to econoff that what MLIT saw through December 2005 was a shift from artificially high bids to bids up to three percent less than the official estimated cost Q- a trend in which firms are under-bidding to win contracts.

17. (SBU) Furthermore, this "bid dumping" became much more pronounced in the Kansai starting this year, with bids as low as 60 Q 70 percent of the government's designated maximum price. The MLIT official felt that in his opinion, firms cannot maintain adequate safety levels at those prices. According to Ito, MLIT is increasing its safety screening as a result.

18. (SBU) Major construction companies can offer such low prices because they have the economic clout to offer their subcontractors less money for their portion of the overall contract without reducing the amount of work the subcontractors have to do -- and while they maintain adequate profit levels, the small-scale construction companies downstream must cope with a profit squeeze. Subcontractors are faced with making hard choices about safety and their own economic viability, according to Ito. However, MLIT's analysis omits the value of increased competition in lowering the cost of competitive bids and improving the terms offered by firms, something the USG has tried to impress upon economic bureaucrats in Japan.

CAN BID RIGGING BE REFORMED IN JAPAN?

19. (SBU) Ito said that although it is not an optimal

situation, there are still too many small construction firms that will go bankrupt without the handout of a subcontracting job from a conglomerate like Obayashi. Since the Japanese labor market has low liquidity, the GOJ is reluctant to push a large segment of low-skilled laborers into the unemployment rolls, hampering the GOJ's ability to end the system of bid rigging and bid dumping.

¶10. (SBU) As in other industries, for the Japanese government underemployment is preferable to unemployment. However, given the storm in the Diet last November over subcontracting architect Hidetsugu Aneha's falsification of mandatory structural strength analyses for hotels and condominiums (essentially caused by the same dynamic of bid dumping by a general contractor), it is surprising that the GOJ has not recognized that putting the public's safety at risk is potentially much more costly in human lives and in yen than increasing its unemployment figures.

¶11. (SBU) Manabu Nojima (please protect), a manager at the Kansai Economic Federation only half-jokingly opined that the Japanese economy is based less on capitalism than market socialism. Many in the business community in Osaka, especially large construction companies, do not think that bid rigging is bad behavior. Instead, they argue that due to its

OSAKA KOBE 00000588 003 OF 003

employment of tottering family operations and underemployable elements of the labor force, bid rigging serves as a form of social security in Japan. Small construction companies serve to sponge up excess unemployment during economic downturns, and release it during periods of expansion. He added that it would be difficult to change irregularities over bidding without changing these attitudes first.

RUSSEL